



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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| Date Amended: | 02/14/09 | Bill No: | ABx3 3 |
| Tax: | Sales and Use Motor Vehicle Fuel Diesel Fuel | Author: | Evans |
| Related Bills: | | | |

BILL SUMMARY

This bill implements various tax provisions related to the 2009-10 Special Session budget agreement. The provisions which impact the Board are as follows:

- Increase the **state sales and use tax rate** by 1 percent beginning April 1, 2009. These provisions sunset on either July 1, 2011, or July 1, 2012, the latter if the voters approve the proposed Budget Stabilization constitutional amendment at a statewide election held during the calendar year 2009.
- Imposes an **additional excise tax on motor vehicle fuel (gasoline) and diesel fuel** of 12 cents (\$0.12) per gallon, beginning April 1, 2009, with an equivalent floor stock tax on those same fuels, as specified. The additional taxes would sunset either July 1, 2011, or July 1, 2013, again depending upon voter approval of the aforementioned proposition.

STATE SALES AND USE TAX RATE INCREASE

ANALYSIS

CURRENT LAW

Under current law, the statewide sales and use tax rate is 7.25 percent. Of the 7.25 percent base rate, 6.25 percent is the state portion and 1 percent is the local portion. The components of the state sales and use tax rate are as follows:

- 5 percent state tax allocated to the state's General Fund (Sections 6051, 6051.3, 6201, and 6201.3)
- 0.25 percent state tax allocated to the Fiscal Recovery Fund (Section 6051.5 and 6201.5)
- 0.50 percent state tax allocated to the Local Revenue Fund which is dedicated to local governments for program realignment (Section 6051.2 and 6201.2)
- 0.50 percent state tax allocated to the Local Public Safety Fund which is dedicated to local governments to fund public safety services (Section 35 of Article XIII of the California Constitution).

In addition to the state portion of sales use tax rate, the following local taxes are imposed by cities and/or counties and are administered by the Board:

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- 1 percent Bradley-Burns Uniform Local Sales and Use Tax which is allocated to cities and counties (Part 1.5, commencing with Section 7200).
- Transactions and Use Tax levied at varying rates from 0.10 to 1 percent by some cities, counties, and special taxing jurisdictions in various cities and counties within the state and which are distributed to those local agencies (Parts 1.6 and 1.7, commencing with Section 7251).

PROPOSED LAW

This bill would add Sections 6051.7 and 6201.7 to the Revenue and Taxation Code to impose a state sales and use tax at a rate of 1 percent.

This bill is an urgency measure and would become effective immediately. However, the sales and use tax rate increase would become operative on April 1, 2009.

The provisions would sunset on either July 1, 2011, or July 1, 2012, the latter if the voters approve the proposed Budget Stabilization constitutional amendment at a statewide election held during the calendar year 2009.

BACKGROUND

California's last state sales and use tax increase occurred in July 1991 with the enactment of AB 2181 (Ch. 85, Stats. 1991). The rate was increased by 1.25 percent in response to the budget shortfall.

Prior to that increase, for a 13-month period beginning December 1, 1989 and ending December 31, 1990, a 0.25 percent state sales and use tax increase was enacted in response to the October 17, 1989 earthquake (commonly referred to as the Loma Prieta earthquake) in the San Francisco Bay Area (SB 33x, Ch. 14x, Stats. 1990, First Extraordinary Session).

Other recent measures related to the state sales and use tax rate include Assembly Bill 7x and Assembly Bill 9e. AB 7x (Ch. 13, Stats. 2003) would have increased the state tax rate by 0.5 percent along with a corresponding decrease of 0.5 percent in the local tax rate as of July 1, 2004. However, these provisions were superseded by the passage of Proposition 57 (AB 9e) in the March 2004 Primary Election, which increased the state tax rate by 0.25 percent along with a corresponding decrease of 0.25 percent in the local tax rate, as of July 1, 2004.

COMMENTS

1. **Purpose.** The purpose of this bill is to provides the statutory tax changes to implement the 2009-10 Special Session Budget agreement to address the fiscal emergency declared by the Governor by proclamation December 19, 2008, pursuant to subdivision (f) of Section 10 of Article IV of the California Constitution.
2. **Suggested amendment – fixed-price contracts and fixed-priced taxable lease agreements entered into prior to the effective date of this bill.** Should the 1 percent sales and use tax increase apply to fixed-price contracts and fixed-price taxable lease agreements entered into prior to the effective date of this bill? As previously stated, the last sales and use tax rate increase of 1.25 percent occurred in July 1991 with the enactment of AB 2181. This same legislation provided an exemption from the increase for certain fixed-price contracts and fixed-priced taxable

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leases that were entered into prior to July 15, 1991. Section 6376.1 provides an exemption from taxes imposed on the gross receipts from the sale of and the storage, use, or other consumption in this state of the following:

- Tangible personal property if the seller is obligated to furnish or the purchaser is obligated to purchase, the property for a fixed price pursuant to a contract entered into prior to July 15, 1991.
- Material and fixtures pursuant to an engineering construction contract or a building construction contract entered into for a fixed price prior to July 15, 1991.
- A lease of tangible personal property that is a continuing sale of the property for any period of time for which the lessor is obligated to lease the property for an amount fixed the lease prior to July 15, 1991.

Because these contracts were negotiated at a fixed amount, when the contractor makes purchases of materials, fixtures, and supplies, the contractor will be subject to the higher tax rate. However, because his or her contract is for a fixed amount, the contractor cannot reimburse himself or herself for the increase in the tax rate. Similarly, the lessor who has entered into a fixed-price contract is subject to the fixed amount. When the lessor reports sales tax on the lease receipts, the lessor must report the tax at the new higher rate. However, because the lease contract is for a fixed amount, the lessor cannot reimburse himself for the additional tax.

Staff recommends adding a new subdivision (b) to Sections 6051.7 and 6201.7, and redesignating the former subdivision (b) as subdivision (c). The new subdivision (b) should be added to proposed Section 6051.7:

(b) All of the following are exempted from the tax imposed by this section:

(1) Tangible personal property if the seller is obligated to furnish or the purchaser is obligated to purchase, the property for a fixed price pursuant to a contract entered into prior to April 1, 2009.

(2) The gross receipts from the sale in this state of material, fixtures, and supplies, if the sale of the material, fixtures, or supplies is obligated pursuant to an engineering construction project contract or a building construction contract entered into for a fixed price prior to April 1, 2009.

(3) A lease of tangible personal property, that is a continuing sale and purchase of that property, for any period of time for which the lessor is obligated to lease the property for an amount fixed by the lease prior to April 1, 2009.

(4) For the purposes of this subdivision, the sale or lease of tangible personal property shall be deemed not to be obligated pursuant to a contract or lease for any period of time for which any party to the contract or lease has the right to terminate the contract or lease upon notice, whether or not that right is exercised.

The new subdivision (b) should be added to proposed Section 6201.7:

(b) All of the following are exempted from the tax imposed by this section:

(1) Tangible personal property if the purchaser is obligated to purchase, the property for a fixed price pursuant to a contract entered into prior to April 1, 2009.

(2) The storage, use or other consumption in this state of material, fixtures, and supplies are purchased from any retailer pursuant to an engineering construction project contract or a building construction contract entered into for a fixed price prior to April 1, 2009.

(3) A lease of tangible personal property, that is a continuing sale and purchase of that property, for any period of time for which the lessor is obligated to lease the property for an amount fixed by the lease prior to April 1, 2009.

(4) For the purposes of this subdivision, the sale or lease of tangible personal property shall be deemed not to be obligated pursuant to a contract or lease for any period of time for which any party to the contract or lease has the right to terminate the contract or lease upon notice, whether or not that right is exercised.

3. **Impact of rate change on the Board.** Tax rate changes historically have had a significant effect on the Board. However, this impact is minimized when the rate change takes place on the first day of a calendar quarter and when the Board has sufficient lead time (at least 90 days) prior to the rate change. Since the proposed tax rate increase would become operative on April 1, 2009, the Board should have sufficient lead time to properly inform the public and prepare revised publications and tax returns.
4. **This bill should contain a specific appropriation to the Board.** This bill proposes a sales and use tax rate increase that would take effect April 1, 2009, which is in the middle of the state's fiscal year. An adequate appropriation would be required to cover the Board's costs incurred in administering the tax rate change that would not be identified in the Board's 2008-09 budget.
5. **Partial tax exemptions would apply to the proposed 1 percent state sales and use tax.** There are six partial sales and use tax exemptions: (1) farm equipment and machinery, (2) timber harvesting equipment and machinery, (3) diesel fuel used in farming activities and food processing, (4) racehorse breeding stock, (5) property used in teleproduction and post production activities, and (6) the rural investment tax exemption. These partial tax exemption statutes contain provisions that exclude the exemptions from any taxes levied pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law and Transactions and Use Tax Law. These partial tax exemptions also do not apply to taxes levied pursuant to Sections 6051.2 and 6201.2 of the Revenue and Taxation Code (also known as the Local Revenue Fund tax), and pursuant to Section 35 of Article XIII of the California Constitution (also known as the Local Public Safety Fund tax). Therefore, the partial tax exemption statutes only apply to the state General Fund portion of the sales and use tax rate.

As of July 1, 2004, the state rate subject to the partial exemptions is 5.25 percent. If the proposed 1 percent increase were to become law, the state rate subject to the partial exemptions would be 6.25 percent.
6. **The 1 percent state sales and use tax would not be included in the calculation of the sales tax prepayment rate on motor vehicle fuel, diesel fuel, and aircraft jet fuel.** Suppliers and wholesalers of motor vehicle fuel (gasoline), diesel fuel, and aircraft jet fuel are required to collect a prepayment of a portion of the sales tax when they remove fuel at the terminal rack, enter the fuel into California, or sell the fuels at any point after the removal from the terminal rack. The Board determines

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the sales tax prepayment rates on these fuels. The rate of prepayment is based on 80 percent of the combined state and local sales tax rate on the average selling price of the fuel as specified in industry publications.

Effective January 1, 2009, the prepayment rates for motor vehicle fuel is \$0.12 per gallon, diesel fuel is \$0.135 per gallon, and aircraft jet fuel is \$0.105 per gallon. These rates are scheduled to remain in effect through March 31, 2010. If the price of these fuels increases or decreases and results in prepayments that consistently exceed or are significantly lower than the fuel retailers' sales tax liability, the Board may adjust the prepayment rates. The Board is required, by November 1 of each year, to establish the prepayment tax rate for these fuels.

Section 6480.1 requires the Board to establish the sales tax prepayment rates. The specific language in the statutes provides that "the required prepayment shall be established by the board based upon 80 percent of the combined state and local sales tax rate established pursuant to Section 6051, 6051.2, 6051.3, 6051.5, 7202, and 7203.1 of the Revenue and Taxation Code and Section 35 of Article XIII of the California Constitution on the average selling price as determined by the State Energy Resources Conservation and Development Commission in its latest publication of the Quarterly Oil Report."

Because Section 6480.1 includes the code sections of each state and local tax component, the proposed 1 percent would need to be added to Section 6480.1. Without this amendment to Section 6480.1, the prepayment rate would not take into account the additional 1 percent rate resulting in lower than normally required prepayment amounts.

COST ESTIMATE

The Board would incur non-absorbable costs related to modifying returns, updating and revising computer programs, notifying all taxpayers registered with the Board, revising publications, training staff, and answering inquiries from the public. In addition, it is anticipated that errors on returns would increase resulting in additional workload in the return processing area. These costs are estimated to be:

FY 2008-09 - \$2,462,420

FY 2009-10 - \$791,007

FY 2010-11 – \$366,200

FY 2011-12 – \$2,150,904

FY 2012-13 - \$691,100

FY 2013-14 - \$358,800

The FY 2011-12, and 2012-13 figures reflect the high costs associated with processing the expiration of the tax increase.

REVENUE ESTIMATE

The annual General Fund revenue gain from a 1 percent increase in the sales and use tax rate would be as follows:

(Millions of Dollars)

| April 1 through June 30, 2009 | FY 2009-10 | FY 2010-11 | FY 2011-12 |
|-------------------------------------|------------|------------|------------|
| \$ 1,187.0 | \$ 4,632.1 | \$ 4,571.9 | \$4,882.8 |

ADDITIONAL TAX ON GASOLINE AND DIESEL FUEL**ANALYSIS****CURRENT LAW**

Under the Motor Vehicle Fuel Tax Law (Part 2 of Division 2 of the Revenue and Taxation Code, commencing with Section 7301), the state imposes an excise tax of \$0.18 per gallon on the removal of gasoline at the refinery or terminal rack, upon entry into the state, and upon sale to an unlicensed person.

Under the Diesel Fuel Tax Law (Part 31 of Division 2 of the Revenue and Taxation Code, commencing with Section 60001), the state imposes an excise tax of \$0.18 per gallon in the same manner.

Under the Use Fuel Tax Law (Part 3 of Division 2 of the Revenue and Taxation Code, commencing with Section 8601), the state imposes an excise tax of \$0.18 per gallon for use of fuels. For liquefied petroleum gas (LPG), liquid natural gas (LNG), compressed natural gas (CNG), ethanol, and methanol, which are types of use fuels, the excise tax rates are \$0.06, \$0.06, \$0.07, \$0.09, and \$0.09, respectively. In lieu of the specified tax rates, an annual flat rate fuel tax may be paid by the owner or operator of vehicles powered by LPG, LNG, or CNG. The flat rate is based on the vehicles weight.

The Sales and Use Tax Law imposes a sales or use tax on the gross receipts from the sale of, and on the sales price of, tangible personal property, unless specifically exempted by statute. Existing law expressly *includes* within the definition of "gross receipts" and "sales price" the amount of any tax imposed by the United States upon producers and importers and the amount of any tax imposed by the state under the Motor Vehicle Fuel Tax Law. The law expressly *excludes* from the definition of "gross receipts" and "sales price" the amount of any tax imposed upon diesel fuel pursuant to Part 31 (commencing with Section 60001).

Therefore, under the existing Sales and Use Tax Law, the computation of sales tax on the sale of gasoline includes the 18.4 cents per gallon imposed at the federal level and the 18 cents per gallon imposed by the State. With respect to sales of diesel fuel, the computation of sales and use tax includes only the 24.4 cents per gallon imposed at the federal level.

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PROPOSED LAW

This bill adds various sections to the Motor Vehicle Fuel Tax Law and the Diesel Fuel Tax Law, to provide for an additional excise tax of \$0.12 per gallon on gasoline and diesel fuel, beginning April 1, 2009, for a combined rate of \$0.30 per gallon.

Motor Vehicle Fuel Tax Law

This bill adds Sections 7360.1, 7360.2, 7361.1, and 7653.1 to the Motor Vehicle Fuel Tax Law.

- Imposes an additional 12 cent excise tax on each gallon of gasoline, beginning April 1, 2009, subject to the tax in Sections 7362, 7363, and 7364.
- All references to the tax imposed pursuant to Section 7360 – the existing \$0.18 excise tax – shall also include the additional tax imposed by this act.
- A floor stock tax of \$0.12 per gallon is imposed on tax-paid gasoline in storage, of 1,000 gallons or more, on April 1, 2009.
- Each supplier, wholesaler, and retailer meeting the floor stock tax requirements would file a floor stock tax return with the Board by May 31, 2009. The amount of tax due is payable to the Controller.

The revenues imposed by the rate increase would be deposited into the Motor Vehicle Fuel Account.

Diesel Fuel Tax Law

This bill adds Sections 60050.2, 60050.3, 60050.4, and 60201.4 to the Diesel Fuel Tax Law.

- Imposes an additional 12 cent excise tax on each gallon of diesel fuel, beginning April 1, 2009, subject to the tax in Sections 60051, 60052, and 60058.
- All references to the tax imposed pursuant to Section 60050 – the existing \$0.18 excise tax – shall also include the additional tax imposed by this act.
- A floor stock tax of \$0.12 per gallon is imposed on tax-paid diesel fuel in storage, of 1,000 gallons or more, on April 1, 2009.
- Each supplier, wholesaler, and retailer meeting the floor stock tax requirements would file a floor stock tax return with the Board by May 31, 2009. The amount of tax due is payable to the Board.

The revenues imposed by the rate increase would be deposited into the Motor Vehicle Fuel Account.

This bill would be effective immediately, as a tax levy, but the additional tax on gasoline and diesel fuel would be operative April 1, 2009. These additional taxes would sunset on either July 1, 2011, or July 1, 2013, the latter if the voters approve the proposed Budget Stabilization constitutional amendment at a statewide election held during the calendar year 2009.

BACKGROUND

In 1990, voters approved Senate Constitutional Amendment 1 (Proposition 111) in the June direct primary election. Approval of this measure made operative Assembly Bill 471 (Ch. 106, Stats. 1989) and Senate Bill 300 (Ch. 105, Stats. 1989). These bills, among other things, increased the rate of tax imposed on most motor vehicle fuels from

\$0.09 to \$0.14 per gallon, effective August 1, 1990. Further, on January 1, 1991, and each January 1 thereafter through 1994, the excise tax increased by \$0.01 per gallon to the current \$0.18 per gallon.

In 2000, Assembly Bill 2114 (Ch. 1053, Longville) changed the point of imposition of the tax up the chain of distribution from the first distribution of the fuel to the removal of the fuel from the refinery or terminal rack. The bill also provided for a backup tax, which applies to the sale and/or delivery of gasoline into the fuel tank of a motor vehicle on which the tax has not been paid or the tax on the fuel has been refunded. The bill also provided for a floor stock tax.

COMMENTS

1. **The bill contains a floor stock tax.** A floor stock tax serves to equalize the excise tax paid on those gallons of fuel held in inventory by a supplier, wholesaler or retailer prior to the effective date of a tax increase and on those gallons purchased after the tax increase. Having a large fuel inventory before a tax rate increase takes effect can bring about a small windfall to a seller, who can raise the selling price of the fuel purchased prior to the increase and attribute the increase in price to the tax rate increase. However, the additional funds collected are profit to the seller and not excise tax paid to the state. A floor stock tax mitigates this windfall.
2. **Both gasoline and diesel fuel state excise tax rates are increased.** The current diesel fuel and gasoline excise tax rates of \$0.18 per gallon remains in effect. This act adds an additional tax, a surtax, of \$0.12 per gallon. The total combined state excise tax rate for gasoline and diesel fuel would be \$0.30 per gallon, effective April 1, 2009.
3. **The Board currently administers the state's fuel excise taxes on gasoline and diesel fuel.** The Board handles various administrative functions that would be affected by a rate increase and floor stock tax, including, but not limited to the following: identifying and notifying taxpayers, developing floor stock tax returns, revising existing returns, modifying computer programming, carrying out compliance and audit efforts to ensure proper reporting, revising publications and internet information, and increasing investigative activities. While the Board processes the payments and refunds for the diesel fuel taxes, the Controller processes gasoline tax payments and refunds. Board staff will continue to evaluate and identify tax and industry related issues that arise from the additional excise tax.
4. **State sales tax revenues.** Existing Sales and Use Tax Law expressly includes within the definition of "gross receipts" and "sales price" the amount of any tax imposed by the United States upon producers and importers and the amount of tax imposed by the state under the Motor Vehicle Fuel Tax Law. Accordingly, the sales tax applies to both the federal and the state excise tax in addition to the sales price of the gasoline itself.

The following is an example of the price per gallon of gasoline computed on a tax-included basis:

| | |
|---|---------|
| Sales price per gallon of gasoline net of all taxes | \$2.240 |
| Federal excise Tax | .184 |
| State excise Tax | .180 |
| Total | \$2.604 |
| Sales tax reimbursement computed at 7¼% of \$2.604 | .189 |
| Total tax-included price per gallon | \$2.793 |

Therefore, if, as a result of this bill, the excise tax on gasoline is increased, then the state sales tax on gasoline would generate corresponding additional revenues.

5. **An increase in the state's excise tax rates may increase evasion.** The Board believes that an increase of 12 cents per gallon, a 67% increase in the present state tax rate, combined with an increase in the price of fuel, would cause an increase in the incidence of tax evasion.
6. **Suggested technical amendments.** In order to clarify certain definitions and to improve administration of the additional excise tax and floor stock tax, the following amendments are suggested:
 - 7361.1. (a) For the privilege of storing for the purpose of sale, each ~~blender, supplier,~~ wholesaler, and retailer owning 1,000 gallons or more of tax-paid motor vehicle fuel on April 1, 2009, shall pay a tax of twelve cents (\$0.12) on each gallon of the tax-paid motor vehicle fuel in storage according to the volumetric measure thereof.
 (b)(3) "Storing" includes the possession in a storage facility, ~~except any fuel included in the bulk transfer/terminal system,~~ or a container of any kind, including railroad tank cars and truck or trailer cargo tanks, of tax-paid motor vehicle fuel, as well as the tax-paid motor vehicle fuel purchased from and invoiced by the seller prior to April 1, 2009, and in transit on that date. Storing, for the purposes of this subdivision does not include any fuel included in the bulk transfer/terminal system.
 - (b)(4) "Tax-paid motor vehicle fuel" means the gallons of motor vehicle fuel acquired on either a temperature-corrected or volumetric basis on which the tax in Section 7360 has been imposed at the time of, or prior to acquisition by, the ~~blender, supplier,~~ wholesaler, or retailer.
 - 7653.1 Each person subject to the storage tax imposed under Section 7361.1 shall, on or before May 31, 2009, prepare and file with the board, ~~on~~ in a form prescribed by the board, a return showing the total number of gallons of...
 - 60050.4. (a) For the privilege of storing for the purpose of sale, each ~~blender, supplier,~~ wholesaler, and retailer owning 1,000 gallons or more of tax-paid diesel fuel on April 1, 2009, shall pay a tax of twelve cents (\$0.12) on each gallon of the tax-paid diesel fuel in storage according to the volumetric measure thereof.
 (b)(3) "Storing" includes the possession in a storage facility, ~~except any fuel included in the bulk transfer/terminal system,~~ or a container of any kind, including railroad tank cars and truck or trailer cargo tanks, of tax-paid diesel fuel, as well

as the tax-paid diesel fuel purchased from and invoiced by the seller prior to April 1, 2009, and in transit on that date. Storing, for the purposes of this subdivision does not include any fuel included in the bulk transfer/terminal system.

(b)(4) "Tax-paid diesel fuel" means the gallons of diesel fuel acquired on either a temperature-corrected or volumetric basis on which the tax in Section 60050 has been imposed at the time of, or prior to acquisition by, the ~~blender,~~ supplier, wholesaler, or retailer.

- 60201.4 Each person subject to the storage tax imposed under Section 60050.34 shall, on or before May 31, 2009, prepare and file with the board, ~~on~~ in a form prescribed by the board, a return showing the total number of gallons of...

COST ESTIMATE

This bill requires the Board, effective immediately, to identify and register additional taxpayers related to the floor stock tax, modify computer programming, revise publications, mail and process additional returns and payments, carry out compliance and audit efforts to ensure proper reporting, and increase investigative activities. From experience, the Board would anticipate the increase in fuel excise tax rates to invite riskier tax evasion schemes. In order to properly protect the state's revenue from increased incidences of tax evasion, the Board would incur higher audit and compliance staff costs with the additional increase in the excise tax rate. A detailed cost estimate is pending, however, Board costs would be major for the current fiscal year.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

This bill imposes an additional excise tax on motor vehicle fuel and diesel fuel of twelve cents (\$0.12) per gallon beginning April 1, 2009, and imposes a floor stock tax of \$0.12 per gallon, as specified.

REVENUE SUMMARY

| | 2Q09 Fuel Tax Revenue | FY 2009-10 Fuel Tax Revenue |
|--------------------------|---------------------------------------|------------------------------------|
| | \$ | |
| Motor Vehicle Fuel | 429,000,000 | 1,714,000,000 |
| Diesel Fuel | 82,000,000 | 329,000,000 |
| | \$ | |
| | 511,000,000 | \$2,043,000,000 |
| | | |
| | Sale & Use Tax Revenue | Sale & Use Tax Revenue |
| | \$ | |
| State(5.00%) | 25,550,000 | \$ 102,150,000 |
| ERBA (0.25%) | 1,278,000 | 5,108,000 |
| Local (2.00%) | 10,220,000 | 40,860,000 |
| Special District (0.71%) | 3,628,000 | 14,505,000 |
| | \$ | |
| | 40,676,000 | \$ 162,623,000 |

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The Board estimates that a floor stock tax of \$0.12 per gallon imposed on tax-paid gasoline and diesel fuel in storage, of 1,000 gallons or more, on April 1, 2009 would generate \$30 million.

| | | | |
|-----------------------|-------------------|--------------|---------------|
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